

The Mariners' Museum

Financial Statements

Year Ended September 30, 2016

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Independent Auditors' Report

Board of Trustees
The Mariners' Museum
Newport News, Virginia

We have audited the accompanying financial statements of The Mariners' Museum, which comprise the statement of financial position as of September 30, 2016, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Mariners' Museum as of September 30, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Dixon Hughes Goodman LLP

**Newport News, VA
March 21, 2017**

The Mariners' Museum
Statement of Financial Position
September 30, 2016

ASSETS

Current assets:

Cash and cash equivalents, operating accounts	\$ 345,424
Accounts receivable - other	155,893
Grants receivable	127,723
Current portion of pledges receivable (Note 3)	308,989
Inventories	145,519
Other current assets	<u>150,264</u>

Total current assets	<u>1,233,812</u>
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Property and equipment, net (Note 5)	<u>27,973,527</u>
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Other assets:

Pledges receivable, less current portion (Note 3)	401,415
Investments	
Cash and cash equivalents, investment accounts	1,090,038
Investments (Note 4)	19,027,863
Beneficial interest in trusts (Note 6)	<u>84,307,151</u>

Total other assets	<u>104,826,467</u>
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Total assets	<u><u>\$ 134,033,806</u></u>
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LIABILITIES AND NET ASSETS

Current liabilities:

Accounts payable	\$ 227,347
Accrued expenses	<u>501,036</u>

Total current liabilities	<u>728,383</u>
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Long-term liabilities:

Charitable gift annuities (Note 8)	56,624
Deferred revenue (Note 9)	6,178,369
Bond payable (Note 10)	<u>9,600,000</u>

Total liabilities	<u>16,563,376</u>
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Net assets:

Unrestricted	30,658,407
Temporarily restricted (Note 11)	2,188,913
Permanently restricted (Note 11)	<u>84,623,110</u>

Total net assets	<u>117,470,430</u>
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Total net assets	<u><u>\$ 134,033,806</u></u>
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The Mariners' Museum
Statement of Activities
Year Ended September 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue, gains and support:				
Income from funds held in trust by others	\$ 4,349,581	\$ -	\$ -	\$ 4,349,581
Realized and unrealized gains on investments - net	388,746	-	1,110,052	1,498,798
Contributions	1,204,149	289,926	150	1,494,225
Admission fees	421,116	-	-	421,116
Dividend and interest income, net	388,247	10,025	1,024	399,296
Miscellaneous	336,855	12,590	(9,384)	340,061
Museum shop	184,734	-	-	184,734
Lease	139,656	-	-	139,656
Grants	-	127,723	-	127,723
Facility rental	119,315	-	-	119,315
Education program fees	75,874	-	-	75,874
Photography	27,137	-	-	27,137
Chris Craft	14,610	-	-	14,610
Deaccession	9,726	-	-	9,726
Publications	2,016	-	-	2,016
Boat house	675	-	-	675
Net assets released from restrictions	912,716	(912,716)	-	-
Total revenue, gains and support	8,575,153	(472,452)	1,101,842	9,204,543
Program expenses:				
Exhibitions	4,101,222	-	-	4,101,222
Conservation	1,235,031	-	-	1,235,031
Research	998,206	-	-	998,206
Program marketing	687,472	-	-	687,472
Programs	847,652	-	-	847,652
Park and Lake	462,326	-	-	462,326
Museum shop	340,962	-	-	340,962
Total program expenses	8,672,871	-	-	8,672,871
Supporting expenses:				
Management and general	716,149	-	-	716,149
Fundraising expenses:				
Development	987,768	-	-	987,768
Special events	230,042	-	-	230,042
Total fundraising expenses	1,217,810	-	-	1,217,810
Total expenses	10,606,830	-	-	10,606,830
Change in net assets	(2,031,677)	(472,452)	1,101,842	(1,402,287)
Net assets, beginning of year	32,690,084	2,661,365	83,521,268	118,872,717
Net assets, end of year	\$30,658,407	\$ 2,188,913	\$84,623,110	\$117,470,430

See accompanying notes.

The Mariners' Museum
Statement of Cash Flows
Year Ended September 30, 2016

Cash flows from operating activities:	
Change in net assets	\$ (1,402,287)
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:	
Depreciation	1,727,416
Change in allowance for uncollectible pledges	(1,415)
Unrealized losses on investments:	
Funds held in trust by others	(1,110,054)
Investments	(388,744)
Change in valuation of charitable gift annuities	9,384
Change in assets and liabilities:	
Accounts receivable	51,945
Grants receivable	(127,723)
Pledges receivable	261,967
Inventories	88,373
Other current assets	(98,015)
Accounts payable	68,502
Accrued expenses	59,712
Deferred revenue	(22,425)
	<u>(883,364)</u>
Net cash used by operating activities	<u>(883,364)</u>
Cash flows from investing activities:	
Property and equipment acquisitions	(497,127)
Sales and maturities of investments	1,855,629
Purchases of investments	(19,681,701)
	<u>(18,323,199)</u>
Net cash used by investing activities	<u>(18,323,199)</u>
Cash flows from financing activities	
Payments on charitable gift annuities	(19,475)
	<u>(19,475)</u>
Net decrease in cash and cash equivalents	(19,226,038)
Cash and cash equivalents, beginning of year	<u>20,661,500</u>
Cash and cash equivalents, end of year	<u>\$ 1,435,462</u>
Cash and cash equivalents, end of year:	
Held in operating accounts	\$ 345,424
Held in investment accounts	1,090,038
	<u>\$ 1,435,462</u>
Cash and cash equivalents, end of year	<u>\$ 1,435,462</u>
Supplemental disclosure of cash flow information:	
Cash paid for interest	<u>\$ 263,527</u>

See accompanying notes.

Notes to Financial Statements

1. Organization and Nature of Activities

The Mariners' Museum (Museum) is a Virginia nonprofit educational and cultural institution which was incorporated in May 1930, and is located in Newport News, Virginia.

The stated mission of The Mariners' Museum and Park is to connect people to the world's waterways through exploration and engaging experiences. The Mariners' Museum uses its art and artifacts to educate local, national and international audiences of all ages about the vital role of the sea in mankind's development. The Museum aspires to be the leader in promoting an appreciation of the maritime world - past, present and future. The Mariners' Museum Park and Lake Maury offer the residents of and visitors to the area the opportunity to experience the beauty and peace of an oasis in the city, to enjoy healthy exercise on the Noland Trail and to enhance their appreciation of the natural habitat of the park.

2. Summary of Significant Accounting Policies

Accounting method

The financial statements of the Museum have been prepared on the accrual basis in accordance with accounting principles generally accepted in the United States of America; revenue and gains are recognized when earned, and expenses and losses are recognized when incurred. The significant accounting policies are described below to enhance the usefulness of the financial statements to the reader.

Basis of presentation

The financial statements report amounts separately by classes of net assets.

Unrestricted amounts are those currently available at the discretion of the Museum's Board of Trustees for use in operations and those resources invested in property and equipment.

Temporarily restricted amounts are those which are stipulated by donors for specific operating purposes or for the acquisition of property and equipment. When a donor restriction is satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Permanently restricted amounts are those donated with a stipulation that they be invested to provide a permanent source of revenue. Such revenue is expendable in accordance with the conditions of each specific donation.

All contributions are considered available for unrestricted use unless specifically restricted by the donor or subject to other legal restrictions.

Cash and cash equivalents

The Museum considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

Inventories

Inventories consist of gift shop items and publications and are stated at the lower of cost (determined using the first-in, first-out method) or market. Inventory related to the Museum Shop was \$101,690 at September 30, 2016, and publications inventory was \$48,552 at September 30, 2016. At September 30, 2016, a valuation allowance of \$4,723 was recorded for slow-moving publications inventory.

**The Mariners' Museum
Notes to Financial Statements**

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 12 for discussion of fair value measurements. Investment distribution or loss (including gains and losses on investments, interest and dividends) is included in the statement of activities as increases or decreases in unrestricted net assets unless the income or loss is restricted by donor or law. The Museum's investments are primarily in equity and fixed income securities and investment income is reported in the accompanying statement of activities, net of investment management fees. The Museum paid management fees, primarily to JP Morgan Chase Bank, of \$267,992 in 2016.

Beneficial interest in trusts represent resources neither in the possession nor under the control of the Museum, but held and administered by outside fiscal agents, with the Museum deriving income from such funds. The trusts are stated at fair value. The assets held in trust are classified as permanently restricted. The distribution received from the trusts is classified as increases in unrestricted net assets in the accompanying statement of activities. Unrealized gains or losses of the assets held by the trusts are reflected as a change in permanently restricted net assets on the accompanying statement of activities.

Property and equipment

Property and equipment are stated at cost on acquisition date or fair value on gift date. Property and equipment, except land and lakes, dams and improvements, are depreciated by the straight-line method over their estimated useful lives as follows:

Building and improvements	5 - 40 years
Furniture and equipment	2 - 20 years
Land improvements	10 - 20 years
The Noland Trail	20 years

Maintenance and ordinary repairs are expensed; improvements are capitalized. Gains and losses arising from disposal or retirement of property and equipment are recognized currently in the accompanying statement of activities and the cost and related accumulated depreciation, if applicable, are removed from the accounts. For donated capital assets, the Museum does not impose a restriction on the length of time the assets must be held. The Museum's policy is to capitalize all items with a useful life greater than one year.

Collection

The Museum maintains significant collection assets, including models, small crafts, prints, paintings, books, photographs, and navigation instruments. In accordance with industry practice, the value of the collection has been excluded from the statement of financial position. Only current year purchases and proceeds from sale are reflected in the statement of activities. It is the policy of the Museum that proceeds from the sale of any collection items are to be used for the acquisition of objects for the permanent collections or for the conservation or maintenance of items currently owned by the Museum by external conservators.

Pledges receivable

Pledges receivable are recognized as revenue in the period the promise is made by the donor. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved when deemed significant. An allowance for uncollectible pledges receivable is provided based upon management's judgment, including such factors as prior collection history and type of pledge.

The Mariners' Museum Notes to Financial Statements

In-kind contributions and donated services

The Museum received in-kind contributions of \$100,000 in 2016. These contributions were primarily related to property repairs. Additionally, the Museum received volunteer hours of 16,052 in 2016. No amounts have been recognized in the statement of activities for donated services because the criteria for recognition under applicable accounting standards have not been satisfied.

Restricted contributions

Contributions received by the Museum with donor-imposed temporary restrictions, which are not met within the same reporting period, are reported as temporarily restricted revenues. The revenue is then shown as released from restrictions on the accompanying statement of activities when the restriction has been satisfied. Donor-restricted contributions whose restrictions are met in the same period are reported as unrestricted support.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Functional expenses

The Museum allocates its expenses on a functional basis among its various programs and supporting services. Expenses that can be identified with a specific program or supporting service are allocated directly. Other expenses that are common to several functions are allocated by various statistical bases. During 2016, the Museum changed its functional expense groupings to align with the current focus areas of the Museum's operations. There was no change to total expenses as a result of these reclassifications.

Advertising costs

Advertising costs are expensed as incurred and were \$270,003 for 2016 and are included in various program and fundraising expense groupings on the statement of activities.

Income taxes

The Museum is a nonstock corporation which has been determined by the Internal Revenue Service to be exempt from taxes on income derived from activities related to its exempt purpose under Section 501(c)(3) of the Internal Revenue Code. The Museum is subject to income taxes on profits, if any, generated from the sale of items in its gift shop which are unrelated to its exempt purpose. The Internal Revenue Service has also determined that the Museum is not a private foundation under Section 509(a)(1).

Credit risk

Financial instruments that potentially expose the Museum to concentrations of credit risk consist primarily of cash and cash equivalents and investments. Cash and cash equivalents and investments are maintained at high quality financial institutions. At September 30, 2016, the Museum had approximately \$1.03 million of cash and cash equivalents on deposit with financial institutions in excess of the Federal Deposit Insurance Corporation (FDIC) limit, most of which was held in the investment accounts.

Subsequent events

In preparing these financial statements, the Museum has evaluated events and transactions for potential recognition or disclosure through March 21, 2017, the date the financial statements were available to be issued.

The Mariners' Museum
Notes to Financial Statements

3. Pledges Receivable

The Museum records pledges receivable as income in the year the promise is received. Pledges receivable include the following:

The Monitor Center campaign	\$ 550,177
General operating and library support	<u>160,227</u>
	<u>\$ 710,404</u>

The anticipated cash flows from pledges receivable is as follows:

Receivable in less than one year	\$ 308,989
Receivable in one to five years	<u>585,000</u>
Total pledges receivable	893,989
Allowance for uncollectible pledges	<u>(183,585)</u>
	710,404
Current portion	<u>(308,989)</u>
	<u>\$ 401,415</u>

4. Investments

Investments are presented at fair value and consist of the following:

Fixed income - US bond funds	\$ 10,196,128
Equity securities - US large cap	4,740,609
Equity securities - Non US	3,402,505
Equity securities - US mid cap / small cap	<u>688,621</u>
	<u>\$ 19,027,863</u>

The investments are under the management of JP Morgan Chase Bank and Wells Fargo Advisors, LLC, who also maintain custody of the securities. At September 30, 2016, \$1,090,038 of cash and cash equivalents is held in the JP Morgan Chase Bank investment accounts.

At September 30, 2016 fair values and unrealized gains are summarized as follows:

	<u>Cost</u>	<u>Fair Value</u>	<u>Unrealized Gain</u>
JP Morgan Chase Bank	\$ 18,510,111	\$ 18,973,691	\$ 463,580
Wells Fargo Advisors, LLC	<u>49,366</u>	<u>54,172</u>	<u>4,806</u>
	<u>\$ 18,559,477</u>	<u>\$ 19,027,863</u>	<u>\$ 468,386</u>

5. Property and Equipment

Property and equipment consist of the following:

Building and improvements	\$ 51,137,844
Furniture and equipment	6,781,560
Land improvements	4,656,952
The Noland Trail	2,219,802
Lakes, dams and improvements	<u>626,901</u>
	65,423,059
Accumulated depreciation	<u>(37,460,841)</u>
	27,962,218
Construction in progress	<u>11,309</u>
	<u>\$ 27,973,527</u>

Depreciation expense for 2016 was \$1,727,416.

6. Beneficial Interest in Trusts

The Museum is the beneficiary of various irrevocable trusts established by the Museum founder, Archer M. Huntington, which are classified as permanently restricted. The Museum receives distributions on the securities held by the trusts. These distributions are reported in the accompanying statement of activities, net of expenses and are included in income from funds held in trust by others.

At September 30, 2016, the value recorded for the beneficial interest in trusts is comprised of the following:

JP Morgan Chase Bank Trust #03152009	\$ 42,315,171
JP Morgan Chase Bank Trust #03583005	28,922,494
JP Morgan Chase Bank Trust #98940006	4,495,595
JP Morgan Chase Bank Trust #98843002	3,207,746
JP Morgan Chase Bank Trust #03152306	1,470,203
JP Morgan Chase Bank Trust #03583302	971,862
SunTrust Bank Trust #13214200	1,806,513
Bank of America (formerly U.S. Trust Co. of New York #239550)	783,499
Bank of New York #676580	165,310
Bank of New York #676730	94,851
Bank of New York #676760	<u>73,907</u>
	<u>\$ 84,307,151</u>

The Museum has adopted a total return policy with respect to distributions received from its Huntington Trust at JP Morgan. This total return policy allows the Museum to receive distributions based upon 4.5% of the rolling average market value of the trusts, using the quarter end value for the preceding twelve quarters, ending with September 30 of the current year. For 2016, the Board of Trustees continued to approve a temporary increase to the total return policy which allowed the Museum to receive distributions based upon 5% of the preceding twelve quarters rolling average of the fair market value of the trusts. The remaining trusts also pay out 5% of the trust assets on an annual basis.

The Mariners' Museum Notes to Financial Statements

The Museum is also a co-beneficiary with three other not-for-profit organizations under the trust agreement with Bank of America (formerly U.S. Trust Co., of New York). Therefore, the amount recorded in the accompanying statement of financial position is 25% of the trust's value, which represents the Museum's share under this split-interest agreement.

7. Retirement Plan

The Museum sponsors a 403(b) Tax Deferred Retirement Plan. The Plan is a defined contribution plan covering substantially all employees. Employees may contribute to the Plan subject to the limitations imposed by the Internal Revenue Service. Effective April 1, 2014, the Museum makes an elective matching contribution of 2% of eligible compensation. The Museum contributed \$61,538 to the Plan during 2016, and this expense is allocated amongst the functional expense categories on the statement of activities based on the number of employees in each area.

8. Charitable Gift Annuities

The Museum holds charitable gift annuities, recognized at fair value. Upon the donor's death, the annuity becomes a part of the Museum's endowment fund, and any subsequent distribution earned is available to support Museum operations. The liability to beneficiaries was \$56,624 at September 30, 2016. The discount rates used to calculate the fair value ranged from 4.2% to 7.6% for 2016.

9. Deferred Revenue

The Museum's deferred revenue consists primarily of four lease agreements for portions of the Museum's land. In connection with the first agreement, the Museum received an advance rental payment of \$5,000,000, and the lease term extends through 2061. The Museum has deferred the recognition of the amount received, and is amortizing the revenue on a straight-line basis over the lease term at an annual amount of \$69,204. The amount deferred is \$3,131,486 at September 30, 2016.

The second lease agreement provides for 20 annual installment payments of \$270,811. The lessee has the option to purchase the land anytime during the lease term, which expires July 5, 2017. The payments include principal and interest at 6% and the Museum recognized lease income of \$27,420 in 2016. The Museum deferred the principal payments, which will be recognized at the end of the lease term. The deferred amount is \$2,622,936 at September 30, 2016.

The third lease agreement commenced on December 1, 2010, and was for an initial term of 20 years. The rent for the initial term was \$65,000, paid upon the commencement of the lease. The lessee had two options to renew the lease for 20 years and an additional 30 years by making payments upon exercise of those options in the amount of \$25,000 and \$20,000, respectively. The lessee has chosen to exercise both options by making the payments with respect to those options. The term of the lease now ends on November 30, 2080. The Museum has deferred recognition of the amount received, and is amortizing the revenue over the lease term at the following rates, \$3,250 annually over the first 20 years, through 2030, \$1,250 annually for the next 20 years, 2030 - 2050, and \$667 annually for the final 30 years, 2050 - 2080. The deferred amount is \$91,042 at September 30, 2016.

The Mariners' Museum
Notes to Financial Statements

During 2012, the Museum entered into a fourth lease agreement, similar to the above. The lease commenced on May 1, 2012, and was for an initial term of 18.5 years. The rent for the initial term was \$143,780, paid upon the commencement of the lease. The lessee had two options to renew the lease for 20 years and an additional 30 years by making payments upon exercise of those options in the amount of \$65,492 and \$42,650, respectively. The lessee has chosen to exercise both options by making the payments with respect to those options. The term of the lease now ends on November 30, 2080. The Museum has deferred recognition of the amount received, and is amortizing the revenue over the lease term at the following rates, \$7,772 annually over the first 18.5 years, through 2030, \$3,275 annually for the next 20 years, 2030 - 2050, and \$1,422 annually for the final 30 years, 2050 - 2080. The deferred amount is \$217,596 at September 30, 2016.

Additionally, the Museum had various deferred amounts of \$115,309 at September 30, 2016 relating to other miscellaneous land leases.

10. Bond Payable

On October 1, 2005, the Museum entered into an agreement with the Industrial Development Authority of Mathews County, Virginia under which it issued a \$10,000,000 fixed rate bank qualified tax-exempt bond, which was unsecured. The Museum has used the proceeds from the bond to finance the 65,000 square foot expansion of the Museum called the USS Monitor Center.

On February 1, 2012, the Museum refinanced the bond arrangement. Under the new agreement with the Economic Development Authority of Lancaster County, Virginia, the Museum was issued a \$9,600,000 fixed rate bank qualified tax-exempt bond, which is unsecured. This new bond issue retired the existing debt. The bond bears interest at a fixed rate of 2.7% and accrued interest on the unpaid principal balance is due monthly through April 1, 2027. On April 1, 2018, the Museum will begin annual principal payments of \$960,000 through April 1, 2027, when the bond is due and payable in full. Interest expense related to these bonds was \$263,520 for 2016, and is included in program expenses on the statement of activities.

Future minimum principal payments are as follows:

<u>Year Ending</u> <u>September 30,</u>	
2017	\$ -
2018	960,000
2019	960,000
2020	960,000
2021	960,000
Thereafter	<u>5,760,000</u>
	<u>\$ 9,600,000</u>

11. Net Asset Restrictions

Temporarily restricted net assets are available for the following purposes:

Program restrictions, including gallery and exhibit funds, artifacts and collection	<u>\$ 2,188,913</u>
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The Mariners' Museum
Notes to Financial Statements

Permanently restricted net assets are invested to:

Beneficial interest in trusts, a portion of the spending rate which is available to support operations	\$ 84,307,151
Endowment funds	<u>315,959</u>
	<u>\$ 84,623,110</u>

During 2016, \$912,716 of temporarily restricted net assets were released from restrictions and used to fund various museum programs that satisfied donor restrictions.

At September 30, 2016, approximately \$8.35 million of unrestricted net assets are Board-designated unrestricted net assets, most of which are designated for gallery upgrades.

12. Fair Value Measurements

Accounting standards established a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Museum has the ability to access.

Level 2: Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2016.

Equity securities: Valued at the closing price reported on the active market on which the equity securities are traded.

Fixed income securities: Valued by a computerized pricing service or, for less actively traded issues, by utilizing a yield-based matrix system to arrive at an estimated fair value at year end.

Pledges receivable: Pledges receivable are reported at net realizable value if at the time the promise is made payment is expected to be received in one year or less. Pledges receivable that are expected to be collected in more than one year are reported at fair value initially and, in subsequent periods, fair value is calculated as the present value of the expected future pledges to be received using a discount rate.

The Mariners' Museum
Notes to Financial Statements

Beneficial interest in trusts: Valued using the fair value of the underlying assets of the trust as an estimate for the present value of the expected future cash flows.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Museum believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following sets forth by level, within the fair value hierarchy, the Museum's assets at fair value:

	Assets at Fair Value as of September 30, 2016			
	Level 1	Level 2	Level 3	Total
Trading securities:				
Cash and cash equivalents held in investment accounts	\$ 1,090,038	\$ -	\$ -	\$ 1,090,038
Equity securities - US large cap	4,740,609	-	-	4,740,609
Equity securities - US mid / small cap	688,621	-	-	688,621
Equity securities - Non US	3,402,505	-	-	3,402,505
Fixed income securities - US bond	-	10,196,128	-	10,196,128
	9,921,773	10,196,128	-	20,117,901
Pledges receivable	-	-	710,404	710,404
Beneficial interest in trusts	-	-	84,307,151	84,307,151
Total assets at fair value	<u>\$ 9,921,773</u>	<u>\$ 10,196,128</u>	<u>\$ 85,017,555</u>	<u>\$105,135,456</u>

The table below sets forth a summary of changes in the fair value of the Museum's level 3 investment assets:

	Pledges Receivable	Beneficial Interest in Trusts
Balance - September 30, 2015	\$ 970,956	\$ 83,197,097
New pledges	445,748	-
Pledge collections	(706,089)	-
Pledges written off	(1,626)	-
Changes in discount and allowance	1,415	-
Adjustment to fair value	-	1,110,054
Balance - September 30, 2016	<u>\$ 710,404</u>	<u>\$ 84,307,151</u>

13. Donor-Designated Endowments

The Mariners' Museum Endowment (Endowment) was established to support its mission. The Endowment substantially contributes to the growth, financial security and the long-term stability of the Museum.

The Mariners' Museum Notes to Financial Statements

The Endowment includes two general categories of funds. One category of funds is donor-restricted funds that are restricted for a particular purpose. The second category of funds is composed of receipts from long-term rentals of real estate (primarily described in Note 9) and gifts and bequests to the Museum by donors, which are unrestricted, which the Board of Trustees has designated to function as permanently restricted endowments. With respect to donor-restricted funds, the net assets associated with these endowment funds are classified and reported based on the existence of donor-imposed restrictions. The Board of Trustees of the Museum has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Museum classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. In accordance with SPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the Museum, and (7) the Museum's investment policies.

Board Designated Endowment. With respect to those unrestricted funds designated by the Board of Trustees to function as endowments, the operative resolution allows the Board of Trustees to set a spending policy based on such factors as the Board determines appropriate, including, but not limited to, the general economic conditions, the needs of the Museum, the possible effect of inflation and deflation, the expected total return from income and the appreciation of investments, and other resources available to the Museum.

The principal of the Board Designated Endowment may be expended only with the prior approval of at least two-thirds of the members of the Board of Trustees in office; provided, however, that during any period of five consecutive years, no more than 25% of the principal of the Endowment, measured as of the beginning of that five-year period, may be expended or distributed. The Museum may make loans from the Endowment to the Museum, for its general purpose or for special programs or projects, upon such terms as the Board of Trustees may determine; provided, however, that any loan shall be considered to be a distribution of principal for the purposes of the approval requirement previously stated.

Investment Return Objectives, Risk Parameters and Strategies. The Museum has adopted investment and spending policies, approved by the Board of Trustees, for endowment assets that attempt to provide a predictable stream of distributions to programs supported by its endowment funds while also maintaining the purchasing power of those endowment assets over the long-term. Accordingly, the investment process seeks to maximize the total return of the Endowment to ensure conservation of the principal while providing appreciable yield, to the extent financially prudent and practicable. Endowment assets are invested in a well-diversified asset mix that is intended to result in a consistent inflation-protected rate of return. Generally, total return shall mean for this purpose that (1) assets are invested to achieve the highest overall return (interest, dividends, and realized as well as unrealized appreciation), consistent with the safety and preservation of the assets and (2) the Board of Trustees, or its designee, may annually determine the amount of the total return that will be treated as distributions available for current use. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

Spending Policy. The Museum Board of Trustees governs the use of the Endowment and identifies the mission related programs and services for which the funds will be used.

Composition of and changes in donor restricted endowment net assets at September 30, 2016, are presented below.

The Mariners' Museum
Notes to Financial Statements

Donor-designated endowment net asset composition is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Donor restricted endowment funds	\$ -	\$ -	\$ 315,959	\$ 315,959

Changes in endowment net assets were as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Endowment net assets, beginning of year	\$ -	\$ -	\$ 324,169	\$ 324,169
Contributions	-	-	150	150
Interest	-	-	1,024	1,024
Net depreciation	-	-	(9,384)	(9,384)
Endowment net assets, end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 315,959</u>	<u>\$ 315,959</u>

14. Leasing Arrangements

The Museum leases a 5,400 square foot building to National Oceanic and Atmospheric Administration (NOAA) under a noncancelable lease that expires in February 2025. The building is included in property and equipment on the statement of financial position at a total cost of \$649,493 offset by accumulated depreciation of \$193,007 at September 30, 2016. The lease agreement provides for annual rental payments of \$2,500 per year plus reimbursement of operating expenses incurred by the Museum for the upkeep and maintenance of the building as a shared expense. The operating expenses are estimated by the Museum at the beginning of each year and split into twelve equal installments to be paid by NOAA. Within 120 days after the end of each year the Museum adjusts the rent charged for the actual operating expenses incurred to NOAA and either credits their future rent or requires additional payment, as necessary. The following is a summary of future minimum rental income under the noncancelable operating lease.

Future minimum payments on the above long-term lease are as follows:

<u>Year Ending September 30,</u>	
2017	\$ 2,500
2018	2,500
2019	2,500
2020	2,500
2021	2,500
Thereafter	<u>7,500</u>
	<u>\$ 20,000</u>

The Museum also has other lease agreements for portions of the Museum's land. The significant agreements are described in Note 9.